PRIVATE EQUITY

Why Pension Funds in Africa should consider Private Equity…and how?

As per current estimates, assets under management will grow from USD 600 bn to USD 7 trillion in the six largest sub-Saharan African countries from 2020 to 2050. Currently, these pension funds have more young members contributing and a low beneficiary ratio.

The investment goal of a pension fund is to generate long-term capital appreciation usually over a period of ten years or longer, while maintaining the asset liability match for current liabilities and cash outflows. This challenge has exacerbated in recent times due to the low to zero interest environment and pension funds and trustees are faced with the pressing question of how to generate risk-adjusted returns to meet their future liabilities.

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Domestically, African pension funds can generate satisfactory returns in traditional asset classes in their local currencies, but face challenges generating equal return in USD or Euros. With increased volatility in commodity markets, combined with the pillaging of natural resources but also less political stability, high inflation and currency depreciation these returns erode and pension funds are confronted with low returns. However, with the current demographic dividend, pension funds have a window of opportunity to optimize their portfolio strategy. The current contributing members will become beneficiaries over next 20 – 30 years, which affords African pension funds a long-term horizon and the incentive to restructure asset allocation.

In an effort to maximize long-term performance, pension funds are shifting more of their assets to the so-called Alternative asset classes, such as Private Equity, Private Debt, Hedge

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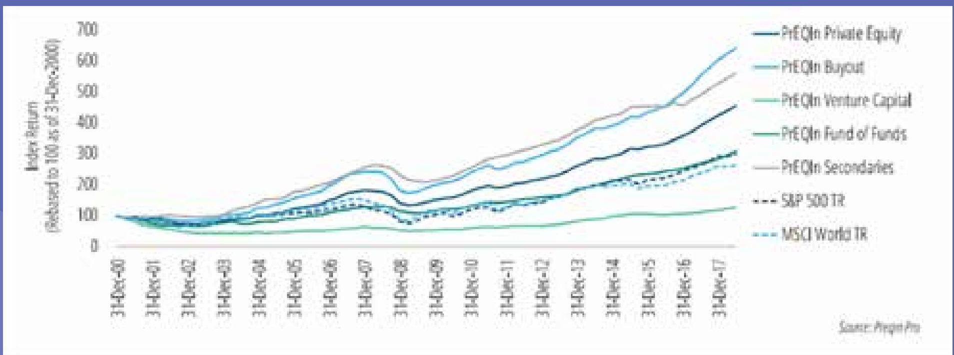
Funds, Infrastructure Funds and others. A new report by the Association of the Luxembourg Fund Industry (ALFI) produced by PwC Luxembourg states that alternatives are expected to play an increasingly important role in pension funds' portfolios as they continue to search for yield. In absolute terms, pension funds' alternatives Assets under Management has risen from USD 9.2 trillion in 2014 to USD 11.6 trillion at the end of 2018.

Allocations to Private Equity fund have been supported by strong historical performance. Since 2007, taking into account the environment surrounding the Great Financial Crises, both Private Equity and Buyout strategies have outperformed the public market, generating strong returns with less volatility than public indices.

Private Equity Strategy vs. Public Markets (Rebased to 100 as of 31 December 2000)



What is Private Equity?

In simple terms, Private Equity is a long-term investment in private, unlisted companies with the potential for growth. In return for investment into the company, Private Equity funds receive equity stakes in the business and partner with management teams to support growth plans and make improvements to the business with the aim of increasing its value. This value is realised through a sale (or exit) of the business, at which point the fund makes a return on its investment.

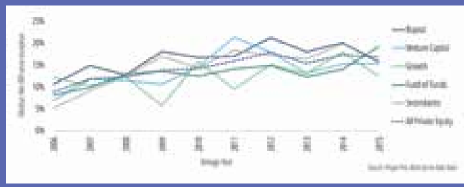
Investments in Private Equity are therefore intrinsically more long-term than traditional investments on the financial markets supporting the pension funds' liability structure. In addition, pension funds looking to align their investments with Sustainable Development Goals (SDGs) and Environmental, Social & Governance (ESG) factors, will find it much easier as most Private Equity firms have developed ESG principles alongside investors' growing appreciation of the non-financial impact of investments.

Ways of accessing the asset class

For pension funds there are a variety of ways to access Private Equity;

- Investing directly into companies.
- Investing into primary Private Equity funds, which generally invest into 10 to 15 companies, providing some diversification.
- Investing into Fund of funds, which invest in many different Private Equity funds, generally creating a portfolio of 10-12 funds and indirect investments in 150 to 200 private companies.
- In addition, any investment strategy can be complimented by secondary investments and co-investments.

Private Equity: Median Net IRRs by Fund Type and Vintage Year



The difficult parts for boards and trustees to understand are manager selection, performance measurement and the effect of fees on returns. Private Equity is quite unlike other asset classes and so boards and trustees need to spend a lot of time getting familiar with the principals inherent in this asset class. Typically, it needs the involvement of experienced people who can evaluate and monitor investments correctly.

The situation of Pension Funds in Africa

Historically where there is an allocation to Private Equity, African pension fund managers have invested predominantly in their respective home countries with main drivers being (A) Domestic markets are familiar and managers have a higher level of knowledge and feel more comfortable in their known home territory; (B) There can often be public and political expectations and incentives to promote the growth and investment into domestic companies; (C) Although it varies country to country, most pension funds have industry restrictions and limits placed on their unlisted and international asset allocations. Relaxed regulatory restrictions have led to an increase in offshore investments in the recent past. International exposure to Private Equity can decrease geographical and currency risk by increasing diversification and putting pension fund assets to work in private companies in the USA, Europe and Asia where returns are currently considerable higher than in African countries.

Strong manager relationships and network are key to ensuring the right fund manager selection. Investing

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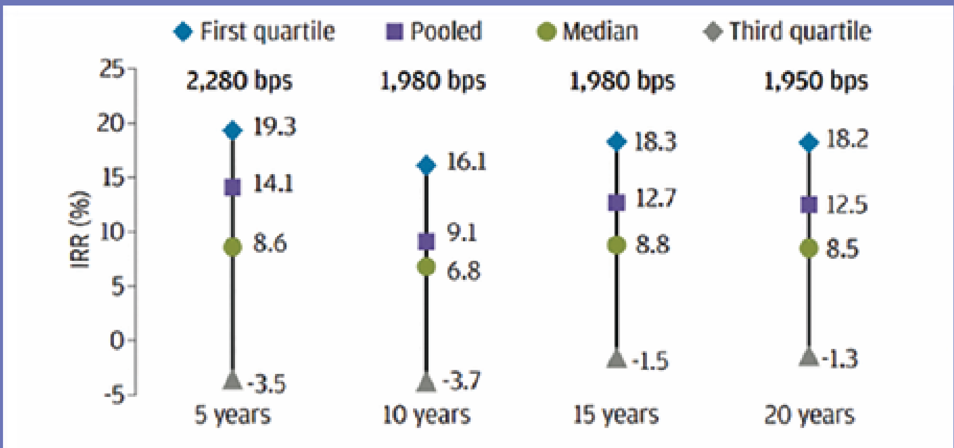
in the best performing Private Equity funds in Europe, the US and Asia is one of the most critical factors in a successful investment program as there is a very widespread between the returns generated by the top and bottom quartile managers.

Dispersion between Top and Bottom Quartile Private Equity funds



Source: Burgiss; data as of September 30, 2017.

The dispersion results are sourced from the Burgiss Manager Universe and are based on the individual internal rates of return (IRRs) as of September 30, 2017, for all private equity funds.

Managing the Challenges

Starting a Private Equity investment programme can be daunting for the pension fund as the characteristics are very different to traditional asset classes. Manager selection, due diligence, performance evaluation and portfolio monitoring, as well as the different fee structures and carried interest does need the involvement of experienced investors who can facilitate and assist with the programme development. Boards and trustees should consider partnering with a specialized Fund of funds manager who can devise a tailor-made international Private Equity program, select the investments, monitor the performance and provide reporting according to regulatory requirements can be an effective way to start the journey.

Here also a vital component of selecting your preferred Fund of Funds manager should be their ability to provide a high level of customization, initial pension fund staff and trustee training, personal support to your investment managers and an ongoing high level of client service as these are key attributes for pension funds allocating to international Private Equity for the first time. If a careful selection is made, then African pension funds can generate higher risk adjusted and absolute returns which are more diversified and less cyclical.■

Svenja Becker - *Managing Partner, Moravia Capital Investments: Svenja founded MCI in 2017. With senior roles over the past 25 years, within a European family office and Credit Suisse, she has substantial experience as an investor in Venture Capital and Private Equity direct investments, co-investments, funds and secondaries across different multiple vintages, geographies and sectors. Over the past 20+ years, Svenja has developed a deep international network across both General and Limited Partners and has been ranked as one of Top 30 Female Limited Partners in Private Equity. She received her M.B.A. from the University of Bamberg, Germany and the University College of Swansea / Wales. With her husband and two kids Svenja lives near Munich.*

Treena Maguire: Director, Investor Relations, *Moravia Capital Investments: Treena started her Private Equity career in 1997 with Greenoak Capital and was a founding member of AltAssets the Private Equity news and research platform in 2000. As head of the Private Equity Client Relations team at Unigestion, the Global specialist Asset Manager she managed fundraising and client service for their fund of funds and customised mandates, before relocating from London to Harare, Zimbabwe in 2010. Since 2012 she has been a director of Albida Advisers, providing consulting services to companies on the ground in Africa and those seeking to access the region.*

Her passion has always been building relationships with institutional investors and developing interesting product to suit and meet investors' appetite and she joined the Moravia team to focus on exactly that in 2019. She holds a BA in Geography and Environmental studies from Liverpool University.